The Concept of Accrual in English Pensions Law: Some Thoughts

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Introduction

'The concept of accrual in English pensions law' would, without qualification, be a big subject. So it is necessary to confine it. I do not have as my ambition to give a comprehensive account of the 'accrual' concept as it is treated in English pensions legislation and cases. The more limited goal is to look at a couple of recent and ongoing developments in pensions case law which touch on the way in which pensions 'accrue' and to ponder their significance. These developments are:

- the *Courage*[1] type of restriction on an amendment power considered in the *Gleeds*[2] case; and
- the decision of Asplin J in *Merchant Navy Ratings Pension Fund v Stena Line*[3] about the meaning of the term 'pensionable service' as it is used in the pensions legislation.

First though, we should define some terms. The dictionary[4] tells us that the word 'accrue' comes from the Latin *ad creso*, meaning 'to grow to', and when we speak of 'accrual' in the pensions context we certainly are talking about how (in the language of member booklets) pensions 'build up', and what you have got when for whatever reason the building-up stops. However, as is obvious from the authorities in relation to *Courage*-type restrictions,[5] this is not an exercise – or not just an exercise – in the intepretation of the words 'accrued' and 'accrual' (and other similar terms) where they appear in pension scheme trust deeds. What we are discussing here is really *how pension benefits are earned*.

There is a connection between the two lines of authority that we are going to look at. In a final salary scheme, where there is a *Courage*-type restriction on an amendment power,

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* Partner, Travers Smith LLP. This article is a modified version of a paper given to the annual conference of the Association of Pension Lawyers in November 2015. I am grateful to my partners Susie Daykin and Paul Stannard for very helpful comments on earlier drafts, and to Jonathan Evans QC and David Pollard for comments made after the paper was delivered on 6 November 2015. Perhaps most importantly, Nicolas Stallworthy QC gave me many interesting comments on the *MNRPF* case in a number of conversations he and I had on the topic in another context. Responsibility for errors and omissions naturally remains my own.

1 [1987] 1 All ER 528.

2 [2014] EWHC 1178 (Ch). Leave to appeal was granted, but at the time of writing it is thought that the case will settle. The effect of a *Courage*-type restriction was also raised in the more recent case of *Sterling Insurance Trustees Limited* v *Sterling Insurance* [2015] EWHC 2665 (Ch) (Nugee J) (otherwise unreported). In this case the parties accepted at first instance that a *Courage*-type restriction precluded an amendment which treated members as if they had left service at the date of amendment (the case being decided on the construction of an amendment power limited to prevent adverse amendments to benefits 'accrued due') but leave to appeal was given on the express understanding that the effect of *Courage*-type restrictions as a matter of law would be raised. It is understood at the time of writing that no appeal will in fact be heard.

3 [2015] EWHC 448 (Ch).

4 *Black's Law Dictionary*, 6th Edn, (West Publishing, 1998) as cited by Scott CJM in *Dinney* v *Great West Life Assurance Co*, 2005 MBCA 36 at para 30.

5 See text following fn 23 ff below.

providing (broadly) that no amendment can reduce the benefits already accrued at the date of amendment, the action taken on the advice of scheme advisers may well be to maintain the final salary link, so that when pre-amendment benefits come to be calculated, the calculation takes not the salary at the date of amendment, but the salary when service actually ends. One of the questions answered by *MNRPF* is: if benefits have been changed, or accrual ended[6] with a final salary link[7] retained in this way, what does that mean for the scheme in terms of the statutory funding and employer debt regimes? Has the scheme become a frozen scheme under the employer debt legislation? Asplin J in *MNRPF* said that it had. Later on we shall have to consider what this decision means for schemes that have made these sorts of amendments retaining a salary link as a result of legal advice based on *Courage*.

Foundations

In relation to the basic question – how are pension benefits earned? – there are a couple of foundations to be laid before we look at *Courage* and *MNRPF* themselves.

Let's start obliquely, by reminding ourselves of a case which is principally relevant as part of the line of authorities dealing with the meaning of the phrase 'retires from service' in an early retirement rule, particularly in the context of incapacity and redundancy.[8] This is *Young* v *Associated Newspapers*[9] (1971), a decision of Brightman J. Mr Young was a journalist, and the father of the *Daily Mail* chapel of the NUJ. He was made redundant when Associated Newspapers integrated the *Daily Sketch* into the *Daily Mail*.

However, the case is not about entitlement to an immediate early retirement pension on redundancy. The rules of the Harmsworth Pension Fund provided that:

> 'a member having at least 10 years[10] of pensionable service and retiring with the consent of the Company … prior to pension age, shall be entitled to a *deferred pension upon attaining pension age at* the rate of one-eightieth of his pensionable salary for each year of pensionable service …'. [emphasis added].

So the case was about whether, having been made redundant after significant amounts of service, an employee had become entitled to retirement benefits *at all*.

Brightman J commented as follows:

> 'It would be natural for the Company, when establishing a non-contributory pension fund, to exclude a dismissed employee from a deferred pension. An employee may be dismissed for a variety of reasons. He may, as in the present case, be dismissed in order to achieve the financial economies which the employer conceives to be necessary or convenient. He may be dismissed for wilfully and intentionally causing immense damage to the interests of his employer. There are infinite shades of colour between those two extremes. *If the plaintiffs' argument is correct the most delinquent employee would be entitled to the same reward in terms of a deferred pension as the most loyal employee. It is hard to*

6 Meaning that no further years will count in the accrual fraction.
7 The case concerned enhanced revaluation, not a final salary link, but the reasoning applies equally to the more common example of a final salary link.
8 See also *Dorrell v May & Baker* [1991] PLR 31*; Harris v Lord Shuttleworth* [1994] PLR 47; *AGCO v Massey Ferguson* [2003] EWCA Civ 1044.
9 11 KIR 413.
10 Mr Young himself did not in fact have ten years' service when dismissed. The other plaintiffs did.

> *suppose that any employer, in his right mind, would knowingly establish a non-contributory pension scheme on quite those lines*.' [emphasis added]

So, according to Brightman J, it is natural and proper for a retirement pension to be a reward for loyalty. A gift. And if you aren't a donee of the gift, you aren't a donee of the gift.

Of course *Young v Associated Newspapers* predated the preservation legislation, which was introduced by the Social Security Act 1973 (a mere two years later) and indeed illustrates exactly the mischief that that legislation outlawed. Evidently Brightman J was out of kilter with the mood of the times.

So one of the main foundations upon which the concept of accrual is built – pensions being earned – is evidently the preservation legislation, and we will come to that in a minute. First, however, let's note two others.

First, there is a long line of judicial authority, stemming from *Kerr v British Leyland*[11] (1986), *Mihlenstedt v Barclays*[12] (1987) and *Mettoy v Evans*[13] (1989), which identifies the important characteristic of pension scheme members, as opposed to the beneficiaries of other types of trust, to be the fact that they are not volunteers, that in other words, they have given consideration for their pension scheme benefits in the form of service as an employee. The classic statement is that of Warner J in *Mettoy:*

> 'as the Court of Appeal has pointed out ... [in *Kerr* and *Mihlenstedt*] the beneficiaries in a pension scheme such as this are not volunteers. Their rights have contractual and commercial origins. They are derived from the contracts of employment of the members. The benefits provided under the scheme have been earned by the service of the members under those contracts and, where the scheme is contributory, pro tanto by their contributions'.[14]

That dictum was given in the context of establishing principles for the construction of pension scheme documents, and was cited with approval by Arden LJ in the leading modern authority on that subject, *Stevens v Bell*[15] (2002). The same thought proved influential in the cases which developed the employer's duty of good faith – *Mihlenstedt* indeed being one of those cases: see Browne-Wilkinson VC in *Imperial Tobacco*[16] (1990) itself. It now forms one of the classic statements of what pensions law is about: it explains why pension schemes are different from other trusts.[17]

11 Eventually reported at [2001] WTLR 2071.
12 [1989] PLR 91.
13 [1990] 1 WLR 1587.
14 At para 127.
15 [2002] EWCA Civ 672.
16 [1991] 1 WLR 589.
17 I have sometimes wondered if it might also explain the enforceability of employer contribution rules, ie other than under the scheme funding (and before that the MFR) legislation. The rule in relation to private trusts generally is that a covenant to settle future property, even contained in a deed, is a contract unenforceable by the beneficiaries (unless they have given consideration, including being within the 'marriage consideration') and moreover that in such a case the covenant should not be enforced by the trustees at law. *Re Pryce* [1917] 1 Ch *234*, *Re Kay* [1939] Ch 329 and *Re Cook* [1965] Ch 902. This is on the grounds that 'equity will not assist a volunteer'. Presumably, on the basis of the *Mettoy* reasoning, pension schemes are like marriage settlements, with their own species of consideration. But this thought does not seem to have been developed in the case law. It was taken for granted in *British Vita* [2007] EWHC 953 (Ch) and *Pilots* [2009] EWHC 1693 (Ch) that an employer covenant to pay contributions in a pension scheme trust is enforceable (absent statutory considerations). (Note that the Contracts (Rights of Third Parties) Act 1999 may apply to generate enforceability in relation to schemes created after that Act came into force where its operation is not excluded.)

Secondly, there is the ECJ jurisprudence on equal pay, which has based itself on the idea that a developing pension right is part of an employee's pay. These cases approach the problem from the other way around – given that pay has to be equal between the sexes, what does pay include? – but the same answer is reached: pensions are pay, albeit *deferred* pay, because they are part of what the employee earns.[18] This is of course the express basis of *Barber* (1990) itself but it is also present in the first part-timer case, *Bilka-Kaufhaus* (1986), and implicit as far back as *Defrenne* v *Belgium* (1971).[19]

Thirdly, there is of course the preservation legislation, which requires that occupational pension scheme rules are framed in such a way as to provide the member who leaves the employer's service before pension age, with a sufficient period of qualifying service, a retirement benefit which is proportionate to the benefit which he or she would have earned had he or she remained in the employer's service until that age. This is a direct policy response to the *Young v Associated Newspapers* problem. It is familiar territory to all pension lawyers, so I must be careful not to labour the point, but we need to remind ourselves of the rudiments of this legislation because it is going to be quite important later on.

This legislation was introduced by the Social Security Act 1973, and is now consolidated in the Pension Schemes Act 1993:[20]

- Section 71 establishes the basic principle that a member of a defined benefit pension scheme with more than two years' qualifying service, and whose pensionable service is terminated before normal pension age, is entitled to 'short service benefit' ('SSB').
- Section 74 explains how short service benefit is to be calculated:
  - 74(1) subject to exceptions, 'a scheme must provide for short service benefit to be computed on the same basis as long service benefit' ('LSB');
  - 74(3) exception 1 applies 'to so much of any benefit as accrues at a higher rate, or otherwise more favourably, in the case:
    - (a) of members with a period of pensionable service of some specified minimum length; or
    - (b) of members remaining in pensionable service up to some specified minimum age;'
  - 74(4) exception 2 applies to 'so much of any benefit as is of an amount or at a rate unrelated to the length of pensionable service . . . ;'
  - 74(6) where either of the exceptions applies, 'short service benefit must be computed on the basis of uniform accrual, so that at the time when pensionable service is terminated it bears the same proportion to long service benefit as the period of that service bears to the period from the beginning of that service to the time when the member would attain normal pension age; and'
  - 74(7) 'where long service benefit is related to a member's earnings at or in a specified period before the time when he attains normal pension age, short service benefit

18 And you cannot, after the pay period, redefine what the pension benefits which were accruing were (so as to achieve equality retrospectively) even where the trust deed would allow it: *Smith v Avdel Systems* (1994) [1994] PLR 211 as applied in *Harland & Wolff* v *Aon* (2006) [2006] EWHC 1778 (Ch).

19 See also *Walker* v *Innospec* [2015] EWCA Civ 1000 per Lewison LJ: underpinning the jurisprudence of the Court of Justice in relation to Art 157 is the principle that pensions are earned by service, and it follows that a requirement of the Framework Directive rendering unlawful discrimination in relation to sexual orientation should not be construed as applying to spouses'/partners' pensions earned by service before the date by which compliance with that directive was required. It cannot be unlawful to pay a pension on terms that were lawful at the time of the service by which it was earned.

20 And the description given here is of the provisions as they are currently in force.

> must be related in a corresponding manner to his earnings at or in the same period before the time when his pensionable service is terminated.'

There are a few structural points to note here.

The 'computed on the same basis' method in s 74(1) will, in a standard scheme which provides an accrual fraction of final salary for each year of service, provide the same SSB computation answer as the uniform accrual method would, had it applied. A 20-year-old joining an n/60ths scheme with NPA of 60 and leaving after 20 years will have accrued 20/60ths payable from age 60 if it is 'computed on the same basis', and this is ½ (20/40ths) of the LSB that would have applied had he or she left service at NPA (40/60ths), ie the uniform accrual method. Both variants have the same goal, which is to assure to the early leaver a benefit which is proportionate in service terms to the benefit earned by the long stayer, necessarily allowing for the salary to which the accrual fraction relates to be taken at the date of early leaving as required by s 74(7).

The uniform accrual method is included to ensure that the policy objective is achieved in any occupational pension scheme, however the benefit is expressed. It is an anti-avoidance provision which prevents the accrual of pension being back-end loaded to deny the early leaver a substantial benefit. There is no assumption that all pension schemes will express the benefit in the form of a yearly accrual fraction, because they may not. So if the benefit is expressed in terms of a salary fraction alone, without any yearly accrual unit at all (say 2/3rds of salary at NPA), uniform accrual will give the earner a personal accrual rate which depends upon his or her age at the time pensionable service begins. (See OPB Memorandum No 78, para 150).

So the accrual of benefits by years of service is a result of the operation of the preservation regime, not a given. Preservation is intended to take any benefit formula and determine how much of it has been earned, year by year.

With those foundations laid,[21] let's look at the two lines of case law.

Courage-type restrictions on amendment powers

In relation to fetters on pension scheme amendment powers of the type discussed in Millet J's decision in *Courage*,[22] the problem is well known. What is the effect[23] if the power is so framed as to deny the ability to amend in such a way as will 'vary or affect any benefits already secured by past contributions' (*Courage*) or 'reduce the value of benefits secured by contributions already made' (*IMG*[24]) or 'prejudice or impair the benefits accrued in respect of membership up to that time' (*Gleeds*[25])?

The answer given by Millett J in *Courage* was that:

21 It is worth noting that the driving concept in the preservation legislation was not given full statutory expression until the enactment of s 67 of the Pensions Act 1995. Until then it was possible to say (in a scheme with a retrospective amendment power without a *Courage*-type restriction, that is) that everything that had been 'earned' before a pension came into payment had been earned subject to the possibility of it being taken away by amendment. For the avoidance of doubt, s 67 is not treated in this paper.

22 [1987] 1 All ER 528.

23 In the absence of express definition – the case concerned two other schemes sponsored by Courage & Sons and in these the restriction preventing adverse amendments to 'accrued benefits' was expressly defined to mean the notional early leaver benefit.

24 [2009] EWHC 2785 (Ch).

25 [2014] EWHC 1178 (Ch).

> 'In the absence of express definition, I see no reason to exclude any benefit to which a member is prospectively entitled if he continues in the same employment and which has been acquired by past contributions, and no reason to assume he has retired from such employment …. when he has not. The contrary argument places a meaning on 'secured' which is not justified.'[26]

This was followed by Arnold J in *IMG*, who indeed went further in attaching negligible importance to the fact that the restriction in the case before him prevented reductions to the *value* of benefits, not to the benefits themselves; this he construed as meaning the *objective* value of the benefits, not their actuarial value at the time of amendment, with the result that the benefits themselves could not be adversely affected lest, on a 'wait and see' basis, they turned out to have been reduced.[27]

The question then becomes: exactly what benefits have been earned by past service, so that they cannot be reduced by amendment?

Underlying the logic of Millett J's terse statement of principle must be a starting point that the benefits a member is striving to earn under a final salary pension scheme are benefits framed in terms both of service and final salary: the employee is motivated to earn a benefit which will be expressed in terms of the salary he or she is ambitious to achieve, not just uprated to combat erosion by price or wage inflation. The fact that promotional salary increases are included as much as increases caused by inflationary pressures is a defining characteristic.

Accordingly the benefits earned in a particular year are to be taken to include the final salary link – what has been earned is to be taken to be a bundle of rights which amount to a formula, not a crystallised amount that can be assessed at the time of amendment, like the notional leaving service benefit at that time.[28]

Developing the line of argument here, it is critical to establish how contingencies are handled when you establish the benefits to which the member is 'prospectively entitled' as a result of past service. Clearly Millett J thought that when you actually retire from service, and the salary that you then enjoy, are both contingencies about which no counterfactual assumption can be made when you test what the benefits that have been 'secured by past contributions' are. You have to wait and see. However, it seems equally that to make sense of this you need to assume that other contingencies do *not* apply: that the scheme is not terminated, for example, or that benefits are not varied by exercise of a discretionary power. The distinction seems to be between contingencies of fact, about which you should keep an open mind, and contingencies of employer or trustee choice, which you should assume do not eventuate[29] (even though if they do occur in fact they will affect the benefits which are protected by the restriction).

We think most often about the final salary link, but it would seem that Millett J.'s formula applies to other benefits too. If a scheme confers a right to a service-related early

26 At p 543 g.

27 Expanding on para 140.

28 As is well known, s 67 of the Pensions Act 1995 defines expressly the 'subsisting rights' of an active member as the notional leaving service benefit.

29 On this basis, you should not let the existence of particular scheme provisions reserving powers to the employers colour the analysis of what benefits have been earned at any particular time. The fact, for example, that the employer has the power to declare any member to be no longer eligible for membership seems to be a discretionary power that you should assume will not be exercised, like the power to trigger a winding up of the scheme. It doesn't of itself show that what the member has earned at a particular time is just the notional leaving service benefit.

retirement pension on incapacity or redundancy, for example, the benefits secured at any particular time must presumably include, on Millett J's analysis, that proportion of the future benefit, including any element calculated by reference to potential pensionable service, that relates to the pre-amendment service.

Until very recently, all the main English cases were cases on the meaning of restrictions which referred to the benefits 'secured' by the scheme or by past service under it.[30] It was widely assumed that the same result would apply if the restriction referred to 'accrued' benefits, but this had not been positively decided;[31] now, in the *Gleeds*[32] case, it has. Newey J saw no reason to give 'benefits accrued' a narrower meaning than 'benefits secured'.[33]

If on a suitable occasion the effect of the *Courage*-type restriction is considered by the courts,[34] there would seem to be three possible outcomes in practice: that *Courage* is rightly decided and has the same effect whatever words are used to impose the protection for past service benefits; that *Courage* is rightly decided but limited to cases where the language concerns the benefits that are 'secured' by past service; or that *Courage* is wrong whatever words are used in the amendment power.[35]

Before reaching any conclusions on this, let's look at how one might construct an argument that the benefit 'accrued' at a particular time is limited to the notional leaving service benefit at that time. The challenge to *Courage* in *Gleeds* was based on submissions that the appropriate construction of '*benefits accrued*' limits the reference to the rights which have 'completely crystallised'[36] at the time of assessment, ie to the notional early leaver benefit. These submissions are based on a series of Canadian cases which we shall have to consider in a moment. However, let's first consider the different senses in which the word 'accrued' is construed outside the pensions context, to see if they shed any light.

The cases cited in *Stroud's Judicial Dictionary of Words and Phrases*[37] would suggest the following classification:

- Not infrequently, 'accrued' is used to mean 'completely constituted'.[38] A cause of action 'accrues' when all its elements have been assembled. An equitable interest in property 'accrues' when it has become vested. In accounting, the 'accruals basis' recognises a liability once it has been incurred.
- However, the word 'accrues' often bears a meaning that is subtly different. When interest accrues 'from day to day', the meaning is that whenever the payment is

30 See *Courage* and *IMG* (fnn 22 and 24 above) and *Lloyds Bank* [1996] PLR 263.

31 The WLR version of Millett J's judgment in *Courage* included a reference to 'accrued benefits' in the same breath as 'benefits secured' in the crucial passage. It is now accepted that this reference was in all probability included in the original draft but excised on review on the grounds that only the 'secured' language was in issue. See *IMG* (see fn 24 above) at para 131 and *Gleeds* (see fn 25 above) at para 117.

32 Fn 26 above.

33 At para 128(iv).

34 In *Sterling* (fn 2 above) the point was not argued at first instance, but reserved for argument on appeal, which sadly (from the point of view of the jurisprudence) is now thought unlikely to proceed. The first instance judgment concerned the construction of an amendment power limited to preclude adverse changes to benefits 'accrued due'. Nugee J construed this to mean 'accrued' on the basis that the word 'due' had been included by a mistake that could be corrected on the basis that 'something had gone wrong with the language' within the principle expounded by Lord Hoffmann in *Chartbrook* v *Persimmon* [2009] 1 AC 1101 at p 2009.

35 I accept that the ratio may be narrower: the case is on the meaning of the word 'accrued' in a particular context. However, *Courage* is also a case on the construction of a particular scheme provision, but Millett J's dictum has been powerful, and we should expect the Court of Appeal's formulation to be powerful in the same way.

36 Paul Newman QC as reported at para 124.

37 At p 27.

38 See also *CASAW* (fn 43 below) at para 48.

ultimately made, the calculation will recognise a daily increment; so too where rent, or any other periodical payment, is apportioned under the Apportionment Act 1870.[39]

- This latter meaning is it seems capable of applying to a calculation which cannot be performed at all until the payment date. If interest, or rent, is to be calculated by reference to an index or some other external benchmark taken at the payment date (rather than day by day), that does not prevent it from having accrued from day to day if that is the applicable apportionment method.

This latter usage is nearest to the sense in which the word 'accrues' is used in a pensions context, to describe how it is earned, unit by unit, even though it may not actually be payable (accrued due) until some later payment date. The question that is begged of course, is what has been earned. In relation to rent or interest it would usually be the case that the rent or interest could be calculated from day to day as well (rather than at the later payment date).

So what of the Canadian cases? Do they support the idea that the 'accrued benefits' at a particular time are represented by the rights which are 'completely crystallised' at that time, and that this is to be taken to be the notional leaving service benefit?

In *Lloyd* v *Imperial Oil*,[40] the scheme provided for an immediate early retirement pension to be payable on redundancy for members with more than ten years' service. The purported amendment added an additional requirement: that the member be aged 50 or more at the time.[41] The amendment power precluded amendments which would 'reduce benefits which have accrued ... prior to the date of ... amendment'. It was held that the the restriction was not violated because at the date of amendment none of the plaintiffs' employments had yet been terminated.

Conversely, in *Dinney* v *Great-West Life Assurance Company*,[42] the purported amendment removed an arguably beneficial escalation provision from pensions already in payment, including Mr Dinney's. Amendments were not permitted which would 'reduce any benefits accrued to the credit of an employee'. It was held that a benefit escalation provision could not be removed.

A third case is *CASAW* v *Alcan*,[43] in which an amendment removing future overtime payments from pensionable earnings was held to be valid, notwithstanding a prohibition on amendments which would 'adversely affect any right with respect to benefits which have accrued'. The judge thought that:

> 'In order to know when an amendment can be made, the employer must have some method of determining what the accrued benefits are, so that it can determine whether they are adversely affected ... the word ''accrued'' according to well-recognised usage has, as applied to rights or liabilities the meaning simply of completely constituted ...'.[44]

Thus:

39 Which applies, however, subject to contrary intention in the instrument creating the payment obligation.
40 2008 ABQB 379.
41 I do not know whether an early retirement pension could be payable under age 50 in accordance with the applicable tax regime in the jurisdiction.
42 2005 MBCA 36.
43 2001 BCCA 303.
44 Para 48.

> 'a plain reading of the words ''right to benefits which had accrued'' prior to January 1, 1990, is that the appellants had a right to have their pension benefit calculated taking into account their highest average earnings, including overtime earned prior to January 1, 1990. They had no right to any benefits resulting from anything that occurred after that date, whether those things were additional earnings, service, contributions or anything else that had not yet occurred.'[45]

What is interesting about *CASAW* is that the judge was inexplicit about the assumptions she was making in determining what rights were 'completely constituted'. She does not say that it is the notional leaving service benefit, although that must be what she means. But the members have not left service. In contrast, in *Lloyd* v *Imperial Oil* it is clear that the judge is saying that the benefit accrues when the final precondition to the benefit becoming payable is satisfied: the benefit is a pension payable on redundancy, but redundancy has not yet occurred. And in *Dinney* the benefit has already accrued in this sense, because the pensions are already in payment. If these cases are right – particularly *Lloyd* – in what sense had the members in *CASAW* v *Alcan* any 'accrued' benefit at all until they had retired?

Another case concerns an amendment altering the destination of surplus. In *Hockin* v *Bank of British Columbia*,[46] amendments could not 'serve to reduce the Members' benefits which have accrued and which have been funded prior to the date of amendment . . .'. The purported amendment removed a provision preventing the bank from taking a repayment of surplus while the scheme was ongoing. The judge held that the benefits which were protected by the fetter were 'the benefits to which the members respectively become entitled under the Plan by virtue of years of service, earnings, marital status and so forth' and that amendments to the destination of surplus were not restricted. But this is really a decision that the ability to participate in surplus is not a part of the 'benefits' provided by the scheme. The word 'accrued' adds nothing.[47] [48]

Where do these cases leave us? Newey J's view, expressed in *Gleeds*,[49] was that it cannot be right that a benefit was 'accrued' only when it was 'accrued due' – and that seems to be exactly what *Lloyd* and *Dinney* require.[50] Moreover, he added that 'a benefit must be capable of accruing even if it might never actually fall due for payment'.[51]

It seems to me that Newey J was absolutely right. If you are to be able to identify the

45 Para 26.

46 [1992] Pens LR 19.

47 And a provision which gave members defined rights to participate in a surplus on winding up would be within the prohibition, being defined by reference to the contingency of winding up.

48 There are two other interesting surplus cases, but they do not concern 'accrued benefits' as such. In the Australian case of *BHLSPF* v *Brashs* [2003] 06 PBLR, the scheme was in winding up. The winding up power had been amended to remove the possibility of discretionary augmentation of members' benefits. Somewhat surprisingly this was held to offend a restriction preventing amendments which would 'operate so as to detract from the benefits secured to a member by the contributions paid to him and by the Company in respect of him prior to the date of [amendment]'. For the reasons explained at para 23, benefits contingent on an exercise of trustee discretion cannot surely be within the universe of 'accrued' or 'secured' benefits. But compare the New Zealand case of *UEB* v *Brabant* (1991) [1991] PLR 109 where the right to participate in a winding up surplus was held to be a part of the members' 'interest in the fund' which was protected by the fetter to the amendment power. It is submitted that this is right: the interest in the fund must include the inchoate interest as an object of a discretionary trust, even though this does not comprise any 'accrued benefits'.

49 Para 128.

50 In the sense of becoming an entitlement. In *Sterling* (see fn 35 above), Nugee J took it that nothing was 'accrued due' under a pension scheme save for a benefit payment once the payment date had been reached.

51 Para 128(ii).

'accrued benefit' at any time before an entitlement to payment has arisen, then it must be on some counterfactual basis or other. The fiction that the accrued benefit equates to the leaving service benefit involves the counterfactual basis that the member leaves service. Why assume that, instead of assuming that the member might carry on until a benefit becomes payable on retirement from service?[52]

The point is crisply illustrated by the following. I have worked on two schemes with *Courage*-style restrictions where, on closer inspection, the restriction was in the rules before the preservation legislation *and before the scheme gave any leaving service benefit as of right*. In such a scheme it must make no sense at all to identify the accrued benefit referenced in the amendment power as a notional leaving service benefit, for when the restriction was introduced, there was none. In such a scheme, the only sense that can be made of the 'accrued benefit' language is to ask what proportion of the ultimate benefits will in fact be referable to pre-amendment service. And if in such a scheme, why exactly not in others, when the member has not in fact left service, and has no intention of doing so? From the member's perspective, given the nature of the final salary benefit, what he or she has earned to date includes the prospective final salary. And that, it is suggested, is the correct analysis of what has been 'earned' by past service, whether expressed by a draftsman in the language of 'benefits accrued' or 'benefits secured'.

Stena v MNRPF

MNRPF discusses a closely related question. If there has been an amendment 'ceasing accrual' in a scheme with a *Courage*-type restriction on the amendment power, with the result that the final salary link has been retained (or, as in *MNRPF* itself, a link to an enhanced rate of revaluation), what consequences does that have? In particular, is the scheme a 'frozen scheme' for the purposes of the Employer Debt legislation?[53]

In *MNRPF* itself, the question was raised in the following way. The scheme was a 'career average revalued' ('CARE') scheme under which components of pension earned by service were revalued, while service with a scheme employer continued, by reference to increases in national average earnings ('NAE'). Cessation of accrual, in the sense that further years of service would not count towards the benefit calculation, occurred on 31 May 2001, but because there was a *Courage*-style restriction on the amendment power, provision was made for NAE revaluation to be applied to the benefits deriving from pre-amendment years of service while the member remained in 'seagoing employment' (broadly, employment with a scheme employer).[54] It mattered whether, in 2001, the scheme had become a frozen scheme, because if it had not, some of the employers termed 'C2 employers' in Asplin J's judgment would subsequently have undergone employment cessation events as a result of all their employees leaving relevant service, thus triggering statutory debts under s 75 but also

52 Another possibility in a case where accrual is ceasing (in the sense of years of accrual counting towards the service fraction) (and which looks like it may have been argued in *Gleeds* but Newey J's comments are a little unclear) is to say that the link to final salary must be retained until pensionable service ends, but no counterfactual assumption is being made if in fact the amendment brings pensionable service to an end. This is a reasonably promising argument, and may emerge as a critical distinction. But it might be vulnerable to the objection that an amendment ending pensionable service (ie the accrual of benefits for future service) is *also* capable of being an amendment reducing past service benefits in defiance of the restriction on the power of amendment.

53 Occupational Pension Schemes (Employer Debt) Regulations 2005 ('Employer Debt Regulations'), reg 9.

54 But see further text under fn 59 below.

relieving them of further prospective scheme funding and employer debt liability[55] to the scheme. If, on the other hand, the scheme had become a frozen scheme in 2001, then the subsequent removal of all employees from seagoing employment would not have had that effect, and prospective liability under s 75 would remain.

Whether employment cessation events would occur in those circumstances depended on:

- whether, on ceasing to have employees in relevant employment between 6 April 2005 and 6 April 2008, a C2 employer 'ceased to be a person employing persons in the description of employment to which the scheme related at a time when at least one other person continued to employ such persons';[56] and
- whether, on ceasing to have employees in relevant employment on or after 6 April 2008, a C2 employer 'ceased to employ at least one person who was an active member of the scheme' while at least one other continued to employ at least one active member, where 'active member' is defined as 'a person who is in pensionable service under the scheme' and 'pensionable service' is defined as 'service in any description or category of employment to which the scheme relates which qualifies the member (on the assumption that it continues for the appropriate period) for pension or other benefits under the scheme'.[57]

The question therefore was whether service in a defined benefit scheme which earns the member no further years of service relevant to the accrual fraction, but which does qualify him or her for a continuing salary link[58] or enhanced revalution, is 'service in a description of employment to which the scheme relates' or (lest it make a difference) such service which 'qualifies him or her ... for pension or other benefits under the scheme'.

In relation to the specific circumstances of the MNRPF, Asplin J decided that it did not. But much of her reasoning is of general application. She based her decision on three reasons.[59]

First, under the MNRPF rules, the application of enhanced revaluation did not in fact rest on continued employment with a scheme employer. The 'seagoing employment' which qualified a member for enhanced revaluation included employment with other Merchant Navy employers, and indeed some periods of unemployment. So service with an employer was not required for that part of the benefit to be available. This point is not of general application, because most schemes which have ceased accrual with a final salary (or enhanced revaluation) link will not provide it to any member who is no longer in the employment of a scheme employer.

Secondly, Asplin J was impressed by submissions made by counsel for Stena that the LPI legislation,[60] which uses the same definition of 'pensionable service', and requires pension attributable to different periods of pensionable service to be increased differently, would be rendered unworkable if service which only qualified a member for a final salary link was included within that definition.

55 But not all funding liability under the rules of the scheme.
56 Employer Debt Regulations, reg 6ZA and incorporated definitions (tense changed), before amendment with effect from 2008.
57 Regulation 6ZA and incorporated definitions, after amendment with effect from 2008.
58 Although to be clear Asplin J was only concerned with enhanced revaluation in the case before her.
59 Paras 402 to 404.
60 Reported at para 377.

Finally, she said that pensionable service must relate only to years of accrual for the preservation or cash equivalent legislation to work. In particular she accepted submissions by counsel for Stena[61] that, on any other basis, it would be impossible to calculate SSB with any certainty.

So what are we to make of this decision? It certainly looks plausible on the facts. If members could qualify for enhanced revaluation even when they weren't in the service of a scheme employer, it seems less convincing than it would otherwise be to say that the enhanced revaluation was a benefit earned by pensionable service.[62] However, I suggest that there are reasons to think the decision might be doubtful, and in some respects it does look rather as if she was heavily influenced by the fact that she was concerned with a CARE scheme with a retained link to enhanced revaluation, rather than with a final salary scheme with a retained link to final salary, even though the points of law she was deciding would apply equally to final salary schemes.

To start with, if she is right, there are some interesting consequences for final salary schemes. Let's take three:

- First, if '*pensionable service*' is defined for statutory purposes[63] as she has held, then at cessation of years of accrual, members will have become entitled to statutory revaluation on their benefit, notwithstanding the final salary link. So that means that any final salary link retained because of a *Courage* style restriction needs to be subject to a statutory revaluation underpin. If *MNRPF* is wrongly decided, then the final salary link will be enough, because pensionable service will not have ended, and the revaluation requirement will not be triggered until final salary is finally crystallised.
- Secondly, suppose that in due course the *Courage*-style restriction comes to be understood differently, with the accrued benefit taken as the leaving service benefit at the amendment date. You might have thought that at that point a scheme which had previously inserted a final salary link on cessation of years of accrual, because of advice about the effect of *Courage*, would be able to amend away that final salary link for the future. But you would be wrong. Section 67 of the Pensions Act 1995, remember, prohibits any detrimental modification to 'any right which at that time has accrued to or in respect of [a member] to future benefits under the scheme rules' with the rider that 'at any time when the pensionable service of a member . . . is continuing, his subsisting rights are to be determined as if he had opted, immediately before that time, to terminate that service.' But in the frozen scheme, the members with the final salary link will not be in pensionable service in the sense used in the Pensions Act 1995. So the rider will not apply, and the final salary link will be inviolable, as part of the 'future benefits' to which the member's accrued rights relate. If *MNRPF* is wrongly decided, then s 67

61 Reported at para 376. I confess to finding these submissions as described difficult to follow.

62 But there is a curiosity here. It seems axiomatic that you can be in a 'category or description of employment to which a scheme relates' without being in the employment of a scheme employer *in the sense* of someone who has adhered to the scheme by accepting non-statutory obligations to the trustees in relation to the funding of the scheme. Warren J effectively said as much in *Pilots*, where some self-employed pilots were held to be persons in the description of employment to which the scheme related. The statutory employer is simply the actual employer in fact of such persons. Does that open up the possibility of an employer being officiously exposed to pension scheme liability by another? Note that under s 1(1) of the Pension Schemes Act 1993 an occupational pension scheme may be founded not only by an employer, but also by an employee. . . . Doubtless a judge would find a way to avoid that conclusion, but it is not entirely clear to me what it would be.

63 Note that there are two similar but different definitions in play: the Pensions Act 1995 definition in s 124(2), and the Pension Schemes Act 1993 definition in ss 181(1) and 70(2). They are treated as having the same interpretation by Asplin J.

will work entirely sensibly if this is the outcome of *Sterling*. The salary link will be capable of being amended away for the future, because *Courage* did not require it and the early leaver fiction which is applicable for the purposes of s 67 allows you to.

- Thirdly, and most importantly, the consequences of *MNRPF* for the future funding of frozen schemes are startling. The purpose of the employer debt regime must be taken, broadly, to be that employers are constrained, so far as they are financially able, to procure that the scheme which they sponsor provides all the benefits which have accrued under the scheme. To that end the employer is required, in circumstances of insolvency or if the scheme enters winding up, to pay an appropriate share of the deficit measured on a buyout basis, so far as it is able. The policy is that, financial resources permitting, where the scheme itself is to be discontinued or to lose all employer support, the trustees should have a claim for an amount which will allow the same benefits to be secured in the insurance market. But employers in a frozen scheme can accelerate their statutory debt by serving an employment cessation event notice,[64] discharging themselves from all future statutory funding liability upon payment of the debt. All the employers could do this, and still no winding up would necessarily be triggered to permit the trustees actually to buy out the benefits. In the ordinary case (where there is no final salary link) this would not be problematic – the trustees would be able to buy in their liabilities or otherwise match them in the gilts market. But in a case where there is a future salary link, two major problems will present themselves. First, it is completely unclear how you identify the amount of a statutory debt where the liabilities themselves are capable of developing (for an indefinite further period) by an amount which exceeds inflation. In no other situation is a statutory debt calculation required when the accrual of the relevant benefits has yet to be completely terminated.[65] Secondly, even if you could place a value on those liabilities in accordance with statutory debt criteria, and made a full recovery, the liabilities would be uninsurable and unmatchable. There would be liabilities developing for future service, without assets to match them, and without any employer with a statutory obligation to fund them. Given the purpose of the statutory debt legislation in which the frozen scheme provisions are housed, this would be a most surprising state of the law.

Two formal reasons were given by Asplin J which are of general application.

For reasons that will become apparent, the second reason should be considered first, in particular her comments about the preservation legislation. It is not at all clear why she thought that the preservation legislation could not be made to work unless pensionable service[66] is limited to years of accrual. As we observed earlier, the preservation legislation has as its objective the creation of a proportionate right to retirement benefit for the early leaver, however the scheme expresses its benefit provisions. It does not start from the assumption that

64 Employer Debt Regulations, reg 9(4).

65 This is obviously true in relation to debts arising on an employment cessation event or on winding up. It will also be true in relation to the debts arising on those types of insolvency that in principle allow employment to continue (for example, administration) if no debt becomes enforceable in a last man standing scheme until the insolvency of the last man, which itself triggers an assessment period which stops future accrual of benefit. That I believe to be the position in law but it may be controversial.

66 There is an important point here: the decision in *MNRPF* is limited to the interpretation of the definition of 'pensionable service' under s 124 of the Pensions Act 1995, but Asplin J's comments about preservation and revaluation must assume that the same interpretation – that pensionable service includes years of accrual only – applies under the Pension Schemes Act 1993. But that definition is in importantly different terms: see text above fn 69.

benefits are expressed in years of accrual; it has as its result that you can say, after application of the legislation, how the benefit has accrued over years, but it does not require you to express benefit in terms of years of accrual at all. Indeed, you can express it in terms of final salary alone with no requirement for years of service ('2/3rds of final salary on leaving service at NPA'[67]) and the preservation legislation will tell you what you need to provide to the early leaver.[68]

Take the example, which seems indistinguishable to me from the case of a scheme where years of accrual have ceased but a final salary link has been retained, where a member enjoys a generous accrual rate subject to a maximum, for example n/30ths of final salary for each year of service but with a maximum of 20 years to count. (This is an example discussed in OPB Memorandum No 78 at para 132.[69]) For a member with more than 20 years' potential service on joining, the years of service after the 20th will qualify him or her only for the final salary link. No other benefits will accrue. Almost by definition, the 20-year cap will often be reached before normal pension age. The legislation assumes that you can be in service qualifying for benefits until NPA. The final salary link must be enough.

Moreover on a close reading the preservation legislation does explicitly provide that pensionable service continues until NPA even where the accrual of years of service has ended:

- 'Pensionable service' is defined in the Pension Schemes Act 1993 as 'service in relevant employment which qualifies the member (on the assumption that it continues for the appropriate period) for long service benefit under the scheme'.
- 'Long service benefit' is defined as 'the benefits which will be payable under the scheme, in accordance with legal obligation, to or in respect of a member of the scheme on the assumption– (a) that he remains in relevant employment, and (b) continues to render service which qualifies him for benefits, until he attains normal pension age'.[70]
- 'Normal pension age' is the 'earliest age at which the member is entitled to receive benefits ... on his retirement from ... employment'.[71]

Working this through, the preservation legislation necessarily assumes that a member has a long service benefit, and this is calculated by identifying normal pension age, and then assessing the benefit at normal pension age if relevant service ended then. But the relevant service for the purposes of the definition is 'service which qualifies him for benefits'. If the scheme design provided that service in the latter years before normal pension age earned on a salary link, then on Asplin J's analysis there would be no service qualifying for benefits at that time. It would thus be impossible to identify a long service benefit. The core concept of the legislation would be inapplicable to such a scheme.

To me this argument is compelling, and ought with respect to lead to the conclusion that Asplin J is clearly wrong in her conclusions on this point.

67 See Memorandum No 78 para 150.

68 See above text from fnn 21 to 22.

69 At first sight it is not entirely clear that this is rightly treated, as it is by Memorandum No 78, as a case to which uniform accrual does *not* apply: you might say that the minimum early leaver benefit ought to be an n/ns proportion of the LSB, not a benefit computed on the same basis as LSB. It is presumably because preservation is designed to prevent back-end loading of accrual, not front-end loading – so s 74(3) does not apply, and s 74(4) does not apply because none of the benefit is actually unrelated to the length of pensionable service.

70 It is true to say that the preservation legislation does not seem able to deal with another theoretical possibility, of a scheme deliberately set up so that the fully accrued pension is a deferred pension payable at some later date. But I am not aware of any such schemes, although of course true frozen schemes are of this type.

71 Pension Schemes Act 1993, s 180(1).

What about s 51? Section 51 deploys the same definition of pensionable service that is used for s 75 – and it assumes that you can split a pension up according to which period of pensionable service it is attributable to: no increases for pension attributable to pensionable service before 6 April 1997; price inflation capped at 5 per cent for pension attributable to pensionable service between 6 April 1997 and 5 April 2005; and price inflation capped at 2.5 per cent for pension attributable to pensionable service thereafter.

There is clearly a powerful argument for saying that the pension attributable to a year of service for these purposes must include the salary link enjoyed during subsequent periods. That is what has always been done in practice, and most schemes have never retained the historic real time salary data that would allow you to split up the pension attributable to a year of service according to when salary increases were actually made.[72] They leave the calculation of contributions to the employer payroll department, and record the salary at date of leaving only.

But let's pause for a moment. The definition of 'pensionable service' requires you to ask whether the service 'qualified the member for benefits'. If the part of a pension which accrued in year 1 is determined by reference to salary in year 10, then on a but-for test the member qualified for an uncrystallised amount of benefit in year 1 and then qualified for the crystallised amount in year 10. Service in all 10 years has an impact, and qualifies the member for benefit, on a literal intepretation. So why discard the literal interpretation?

To get to the bottom of this, we surely need to look more closely at the purposes the 'pensionable service' definition serves. The answer seems to be that it serves two main purposes, and that they point in different directions. One is to identify the *amount* of service that is relevant to splitting the benefit into tranches – as under LPI and revaluation legislation. There needs to be only one answer to the question, 'to what period of pensionable service is this part of the pension attributable?' because otherwise the function of deciding how it splits will not be fulfilled. But the other main purpose is instead to identify the *quality* of service for some purpose, for example (and critically) whether a person is an employer of persons accruing benefits under the scheme in the relevant sense. And as we have seen above, it is arguable that for the policy of the employer debt legislation to be properly effective, a mere salary link should be enough to count as accrual for this purpose.

So the unitary definition of 'pensionable service' doesn't really work properly. To match the policy objectives, it needs to be given different purposive meanings in different contexts. It seems to me that it needs its literal meaning in the context of the employer debt legislation, and a more limited (years of accrual) meaning in the context of the LPI and revaluation legislation, these being contexts which require the literal meaning of the definition to be displaced in accordance with the canons of statutory interpretation.[73] In fact there is a strong clue about when the restricted interpretation needs to be used: it is when the phrase 'benefits attributable to pensionable service' is used. On a purposive interpetation, the 'benefits attributable to pensionable service' would be understood as a subset of the benefits for which that pensionable service 'qualifies' the member within the meaning of the s 124 definition itself.

Indeed the legislative antecedents of the LPI legislation would be entirely consistent with this. The framework for the LPI legislation was set in s 58A of the Social Security Pensions Act 1975 (as amended by the Social Security Act 1990) which was never brought

72 And longstanding actual practice in the pensions arena is admissible to construction: see Arden LJ in *Stevens* v *Bell* [2002] EWCA Civ 672 at para 30.

73 See *Bennion on Statutory Interpretation* 6th Edn, (LexisNexis, 2013) at section 199.

into force. This in turn built upon the framework set for the very first occupational pension increase requirements, those requiring the increase of the post-1988 GMP, contained in s 37A of the SSPA 1975 (as amended by the Social Security Act 1986). The relevant formulation was 'an increase of the rate of that part of guaranteed minimum pensions which is attributable to *earnings factors* for the tax year 1988–89 and subsequent tax years' and the s 58A innovation simply took that model and changed 'earnings factors' to 'pensionable service'. But of course earnings factors are units of accrual which have their own rate of increase built in: an earnings factor for a tax year is defined as the earnings in the tax year *increased by NAE over the period since then*,[74] and there is therefore no ambiguity about how the GMP is being sliced. That is the model that was being inherited by the LPI legislation. There is every reason to suppose that the context requires a different interpretation to be given to the statutory definition of 'pensionable service' in relation to LPI and revaluation than in relation to other parts of the pensions legislation, ie where the formulation 'benefits attributable to pensionable service' is used.

Conclusion

I have sought to look at two related judicial developments which help define what is earned by an employee in a defined benefit pension scheme, and how it is earned. In relation to *Courage*-style restrictions, we look forward to what the Court of Appeal has to say in *Sterling*. In relation to what '*pensionable service*' in the statutory sense means, it will be interesting to see what consensus develops around the decision in *MNRPF*, and whether it is followed in other cases.

74 SSPA 1975, s 21(3): '[if] the Secretary of State concludes, having regard to earlier orders under this section, that earnings factors for any previous tax year (not being earlier than 1978–79) have not, during the period taken into account for that review, maintained their value in relation to the general level of earnings, he shall make an order directing that those earnings factors shall, for the purpose of any such calculation as is mentioned in subsection (1) above, be increased by such percentage of their amount, apart from earlier orders under this section, as he thinks necessary to make up that fall in their value together with other falls in their value which had been made up by such earlier orders.'